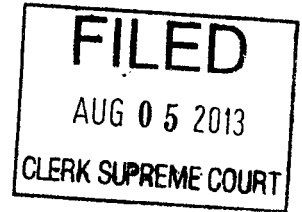


OFFICE OF PROFESSIONAL REGULATION  
OF THE SUPREME COURT OF IOWA



Judicial Branch Building, 1111 East Court Avenue, Des Moines, Iowa 50319  
Telephone (515) 725-8029 Facsimile (515) 725-8032

Memorandum For: Publication

From: Paul H. Wieck II, Director

Subject: Proposed Client Security Rule Changes

Date: August 5, 2013

**Table of Contents**

Introduction . . . . .	1
Proposed Rule Changes . . . . .	2
Iowa Court Rule 39.6 . . . . .	2
Iowa Court Rule 40.3 . . . . .	3
Background Information . . . . .	3
Role of the Client Security Trust Fund in Lawyer Regulation . . . . .	3
Overview of the Fund . . . . .	3
Contributions to the Fund . . . . .	5
Current Claim Limits . . . . .	7
Past Claims Experience . . . . .	7
Operating Expenses of the Fund . . . . .	9
The Role of a Reserve . . . . .	10
Effect of Increased Assessments on Iowa Lawyers . . . . .	11
Effect on Future Special Assessments . . . . .	12
How Iowa's Fund Compares with Other States . . . . .	13

## **Introduction**

In early 2013, claims exceeding \$800,000 were filed with the Client Security Commission (the commission) based on the actions of a lawyer whose license to practice since has been revoked. These claims brought into play the limit on the amount payable on an individual claim, which has happened several times in the past. These claims also brought into play the maximum *per lawyer* limit on claim reimbursements, for only the second time in the history of the fund, and to an extent never before experienced in Iowa.

Because the limits on reimbursement have not been adjusted for almost thirty years, the consensus of the commission was that the claim reimbursement limits should be reexamined. The reexamination process resulted in recommendations to the Supreme Court by the board of governors of the Iowa State Bar Association and the Client Security Commission. Both organizations recommend increasing the claim reimbursement limits, increasing the sufficiency threshold used to maintain the balance of the Client Security Trust Fund (the fund), and increasing special assessments payable by Iowa lawyers to support the fund. The following comments provide background regarding the fund and the rule changes proposed based on the recommendations received by the Supreme Court.

## **Proposed Rule Changes**

### **Iowa Court Rule 39.6**

All lawyers newly admitted to the Iowa bar pay an initial assessment of \$200 to the fund. Lawyers admitted on motion begin paying the initial assessment in installments commencing the year of admission. Lawyers admitted by examination begin paying the initial assessment in installments beginning in the third year of admission. Lawyers in full-time private practice pay \$50 installments each year until the initial \$200 assessment is paid. Lawyers in government, corporate, or part-time status pay \$25 installments each year until the \$200 assessment is paid. The proposed change would retain the initial assessment of \$200, but would make the installments in which it is paid uniform at \$50 per year regardless of practice status. This change would be effective for all installments paid after January 1, 2014.

Each December 1<sup>st</sup> the commission calculates the net value of the fund, deducting the pending claims and requests for reimbursement and all other expenses chargeable against the fund. If the net value equals or exceeds \$600,000, no special assessment is payable by lawyers in the following year. If the net amount is less than \$600,000, a special assessment is payable by all active lawyers who previously have paid their initial assessment of \$200 to the fund. The proposed change would increase the threshold for the annual

sufficiency calculation to \$1,200,000, effective for the calculation to be performed December 1, 2013. Coupled with the current fund balance, the increase in the threshold is expected to prompt a special assessment during 2014 and again during 2015. After 2015, special assessments are expected to be payable every three to four years.

The special assessment payable in a year after the sufficiency calculation falls below the established threshold currently varies depending on practice status. Lawyers in full-time private practice pay a special assessment of \$100 in a special assessment year. Judges, government lawyers, corporate lawyers, and part-time practitioners pay a special assessment of \$25. The proposed change would make the special assessment uniform at \$140, payable by every active lawyer who previously has paid their initial \$200 assessment, regardless of client security status. This change would be effective for all special assessments paid after January 1, 2014.

The proposed uniformity in the special assessment and installment payments of the initial assessment is based on the premise that all lawyers, regardless of practice status, share a common obligation and interest as members of the profession to support self-regulation, maintain the reputation of the bar, and compensate those harmed by dishonest acts of bar members.

#### Iowa Court Rule 40.3

The proposed change would increase the reimbursement limits for claims against the fund. The current limit on an individual claim would increase from \$50,000 to \$100,000. The current limit on total claims payable as a result of the conduct of any one attorney would increase from \$150,000 to \$300,000. The increase in the reimbursement limits would be effective for claims arising from lawyer conduct occurring on or after January 1, 2014.

### **Background Information**

#### Role of the Client Security Trust Fund in Lawyer Regulation

The fund is one part of the Iowa bar's effort to protect clients. In addition to the fund, the commission operates two major loss prevention vehicles - periodic trust account audits and the trust account overdraft notice program - to help limit losses by clients. The lawyer assistance program, continuing legal education program, lawyer discipline system, and trust account rules also play a role in protection of clients.

## Overview of the Fund

The fund and the commission were activated on January 1, 1974 by the Supreme Court, at the voluntary request of the lawyers of Iowa. The purpose of the fund is set out in Iowa Court Rule 39.3(3):

The purpose of the fund shall be to prevent defalcations by members of the Iowa bar, and insofar as practicable, to provide for indemnification by the profession for losses caused to the public by the dishonest conduct of members of the bar of this state . . . .

The fund is intended to be a source of last resort, in those situations where there is no other source for reimbursement of a client's loss. Payments from the fund are discretionary, and are subject to pending claims and fund assets, the claimant's loss as compared to losses of other eligible claimants, the degree of hardship suffered by the claimant, and the degree to which the claimant contributed to the loss. No other profession provides a self-funded reimbursement program of this kind.

The principal operations of the commission and the fund are:

Administration of the client security claims process, including investigation, processing, and payment of claims approved by the commission. In recent years the commission and staff have investigated and considered an average of 25 claims per year.

Assistance to trustees appointed to administer law practices under the provisions of Iowa Court Rules 35.17 (disability) and 35.18 (death or suspension). Commission staff members provide sample forms, advice regarding handling of specific issues, and process trustee fee and expense claims for approval and payment.

Financial administration of the fund, including annual budget design and approval, monthly accounting, employee payroll and benefits processing, payment of operating expenses, and coordination of annual audits by an independent certified public accounting firm.

Administration of loss prevention and compliance programs intended to reduce losses due to attorney defalcation, including:

The trust account audit program. Four part-time auditors employed by the commission perform regular and special audits of law firm trust accounts. Fiduciary accounts are examined incident to the normal trust account audits. The goal is to audit each trust account every three to four years. In a normal year, the auditors will examine 320 to 600 trust accounts associated with 550 to 1250 private practitioners, and examine

150 to 500 fiduciary accounts. The number of trust accounts audited and number of practitioners involved tend to be reduced in a year when substantial special audit activity is necessary, as has been the case the past few years. Special audits are conducted for cause, or based on risk assessments. In recent years, for example, special audits have been conducted when newly admitted lawyers open their own practices, to help them properly establish and operate their trust accounts.

The trust account overdraft reporting program. Each Interest on Lawyer Trust Account (IOLTA) bank reports trust account overdrafts to the responsible law firm and to the commission. Commission staff members follow up regarding each overdraft notice to ascertain the cause for the overdraft and remedial measures adopted by the firm. When a satisfactory response is not timely received, a special trust account audit may be conducted. The staff handles approximately 50 - 75 overdraft notices each year.

The annual trust account questionnaire. Questionnaires received from each of the approximately 9,000 active lawyers annually are reviewed for compliance with trust account rules. Responses indicating possible lack of compliance are followed up by commission staff and may result in a special trust account audit.

Commission staff members regularly present continuing legal education sessions regarding trust accounting operations, lawyer succession planning, and other professional regulation topics. Routine appearances include the basic skills course for new lawyers, the ISBA Nuts & Bolts seminars each fall, the annual ISBA fall traveling seminar, and the ISBA annual meeting.

Commission staff members prepare and maintain outlines and forms for lawyers regarding topics germane to loss prevention, including trust account administration, law firm succession planning, and fraud avoidance.

Commission staff members review instances of lawyer defalcation and failure to meet trust accounting standards. Referrals to the Attorney Disciplinary Board are made when warranted (with commission approval), and referrals for criminal prosecution are made when warranted (with commission and Supreme Court approval).

Preparation and submission of annual reports to the Supreme Court regarding commission activities.

Preparation and submission of recommendations for rule changes to the Supreme Court when warranted.

## Contributions to the Fund

Each lawyer admitted to practice or registered as house counsel in Iowa contributes to the fund. Lawyers admitted by examination within the past two years or in active duty military service status are exempt from payment of assessments into the fund. Lawyers categorized as government employees, full-time corporate employees, judges, or part-time practitioners each contribute assessments of \$25.00 annually to the fund until they have paid assessments totaling \$200.00. Lawyers classified as full-time practitioners are required to contribute to the fund at the rate of \$50.00 each year until they have paid assessments totaling \$200.00.

Once the initial assessment has been paid, no further assessment is payable unless the sufficiency calculation required by Iowa Court Rule 39.6 results in an unrestricted fund balance of less than \$600,000 as of December 1<sup>st</sup>. If that calculation declines below \$600,000, a special assessment is payable by all active lawyers during the next calendar year. The special assessment payable by full-time practitioners is \$100.00. The special assessment payable by judges, corporate, government, or part-time lawyers is \$25.00.

Assessments Payable by Attorneys in Various Client Security Statuses Under Current Rules					
	Initial Assessment			After Initial Assessment Has Been Paid	
Client Security Status	Year of Admission	Year After Admission	Following Years, Until Initial Assessment is Paid	Not a Special Assessment Year	Special Assessment Year
Full Time	\$0	\$0	\$50	\$0	\$100
Part Time	\$0	\$0	\$25	\$0	\$25
Judge	\$0	\$0	\$25	\$0	\$25
Corporate	\$0	\$0	\$25	\$0	\$25
Government	\$0	\$0	\$25	\$0	\$25
Military	\$0	\$0	\$0	\$0	\$0

During the life of the fund, special assessments have been paid three times - in 2005, 2008, and 2011. In a year in which no special assessment is collected, the commission's total receipts average \$108,000, approximately \$62,000 of which comes from initial assessments. In a year in which a special assessment is collected, the commission's total receipts average \$580,000, of which \$534,000 comes from assessments.

The amounts set for the initial assessment and special assessments have not changed since the fund was established in 1974. If Consumer Price Index (CPI) inflation rates are applied based on the almost 39 years since the assessments were established in 1974, the current assessments would be over 4.7 times greater than they currently are. During the first years of a newly admitted lawyer's career, he or she would contribute an initial assessment of \$941.85 to the fund. If the unrestricted balance of the fund declined below the \$600,000 threshold, all active lawyers would contribute a special assessment of \$117.73 or \$470.92, depending on the lawyer's practice status. In a year in which no special assessment is collected, the commission's total receipts would average over \$337,000. In a year in which a special assessment is collected, the commission's total receipts would average \$2,555,000.

The following table compares the income generated if the initial and special assessments remain the same, if they are increased to reflect the CPI inflation rate, if they are simply doubled, and if the initial assessment remains \$200 but the special assessment is standardized at \$140 as proposed.

<b>Client Security Commission Income Projections Based on Alternatives for Increased Client Security Assessments</b>						
Type of Year		Income		Income		Income
		Current Assessment Structure		Both Assessments Increased Per CPI (470%)		Both Assessments Doubled
Normal Assessment Year	Total	\$108,000		\$337,400		\$170,000
	Assessments	\$62,000		\$291,400		\$124,000
	Other Income	\$46,000		\$46,000		\$46,000
Special Assessment Year	Total	\$580,000		\$2,555,800		\$1,114,000
	Assessments	\$534,000		\$2,509,800		\$1,068,000
	Other Income	\$46,000		\$46,000		\$46,000

## Current Claim Limits

Iowa Court Rule 40.3(6) establishes limits on reimbursement by the fund. The maximum amount any one claimant may recover from the fund is \$50,000, and the maximum amount reimbursable due to the actions of any one attorney is \$150,000. These claim limits were last increased almost 29 years ago. If CPI inflation rates are applied from the time of the last adjustment in 1984 through the present, the limit per claim now would be \$111,725, and the aggregate limit per lawyer now would be \$335,177.

## Past Claims Experience

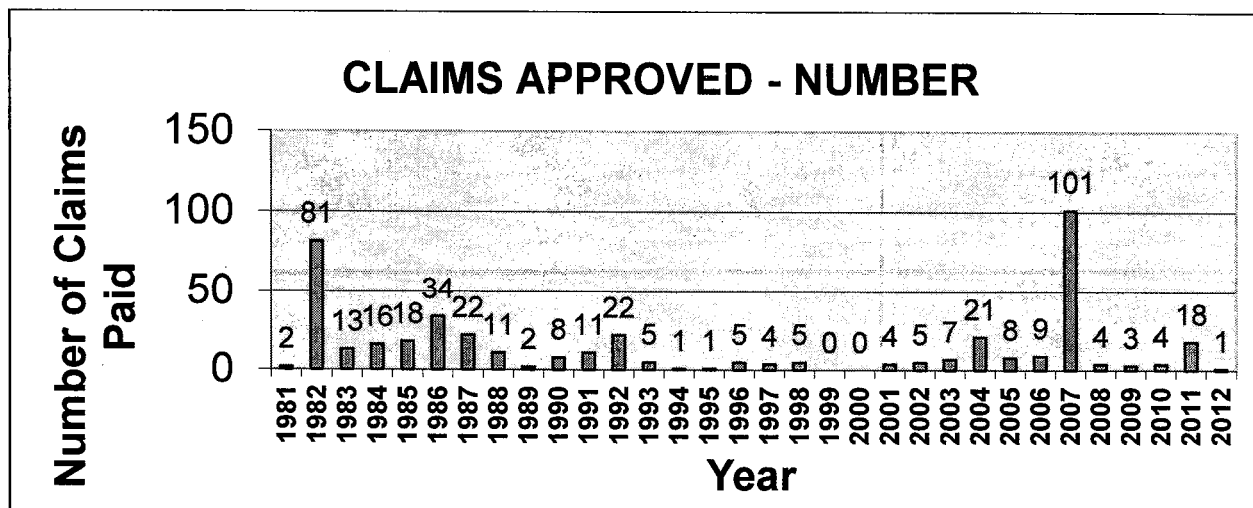
From inception of the fund through 2012, the limit on individual claims was applied eleven times.

- 1983 – 1 claim capped at \$25,000 (Robert C. Gross)
- 1989 – 14 claims capped at *per lawyer limit* of \$150,000; 1 individual claim capped at \$50,000 (Fred Dumbaugh)
- 1992 – 1 claim capped at \$50,000 (David Brodsky)
- 1997 – 2 claims capped at \$50,000 each (George Capps, John Randall)
- 1998 – 2 claims capped at \$50,000 each (Charles Jacobs)
- 2003 – 3 claims capped at \$50,000 each (Howard Myers – 2; N. Leroy Walters – 1)
- 2011 – 1 claim capped at \$50,000 (Kristine Corcoran Frye)

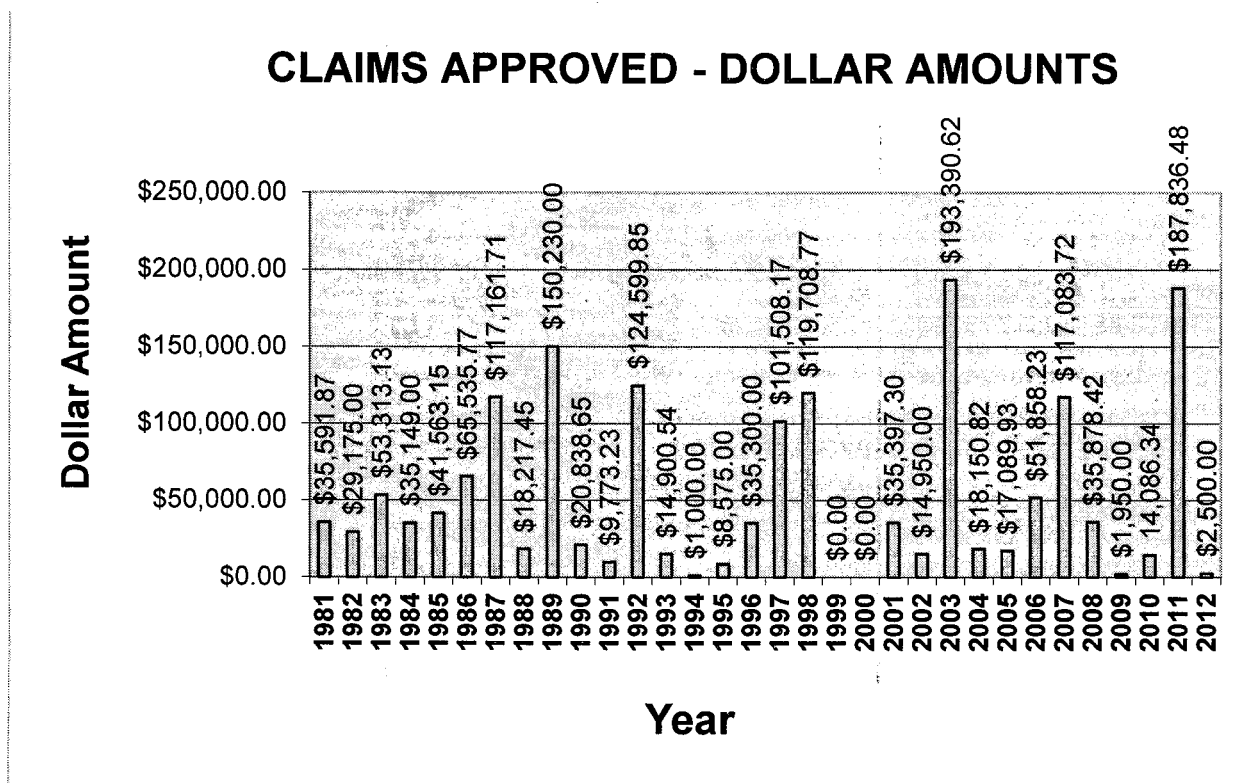
The aggregate, per-attorney limit was applied only once through 2012. The attorney in that case was Robert “Fred” Dumbaugh of Cedar Rapids. The total claims of \$526,243.50 arising from the actions of Mr. Dumbaugh were partially reimbursed by a fiduciary bond or bonds, leaving remaining claims in the amount of \$198,859.81 against the fund. The per claim limit was applied to one claim, which reduced the compensable claim total to \$161,806.55. The claims were reimbursed at the rate of 92.7% of their compensable amounts.

The following graph shows the number of the claims the fund has paid each year from 1981 through 2012. Over the life of the fund, a total of 446 claims have been reimbursed.





The following graph shows the actual reimbursements paid each year from 1981 through 2012. Over the life of the fund, total reimbursements of over \$1,691,721 have been paid. In addition, fees and expenses totaling \$233,609.49 have been paid over the life of the fund for trustees appointed under the provisions of Iowa Court Rules 35.17 and 35.18.



## Operating Expenses of the Fund

The Office of Professional Regulation provides program support and administration for nine different board and commissions, with a full-time staff of seven at the main OPR office, plus four part-time client security auditors. The separate office of the Attorney Disciplinary Board handles the investigation and prosecution of ethics complaints lodged against Iowa lawyers. Each of the nine boards, commissions, or functions administered by OPR is a separate financial entity, and contributes its proportionate share of the operating costs of the office.

As shown in the following table, commission operating costs after removing claims, trustee fees, depreciation, and amortization have been running consistently around \$250,000 in each year for several years.

<b>Summary of Client Security Commission Operating Expenses</b>				
Per Audit, Fiscal Year				
	Year			
	2012	2011	2010	2009
Total Operating Expenses per Audit	\$392,150	\$430,455	\$296,928	\$313,829
Less Amortization	\$22,244	\$22,778	\$22,778	\$22,778
Less Depreciation	\$976	\$894	\$768	\$491
Less Claims Paid	\$114,844	\$153,972	\$16,872	\$44,078
Net Regular Cash Operating Expenses	\$254,086	\$252,811	\$256,510	\$246,482

The annual average expense total of \$250,000 includes the costs associated with the trust account audit program, which alone accounts for over \$100,000 per year for 3,000 to 3,200 hours of auditing plus auditor travel expenses. The remaining \$150,000 in expenses covers all personnel costs, facility, supply, and utility expenses attributable to the commission. The full-time staffing for the commission consists of 1.4 full-time equivalent (FTE) staff members. Consolidation of administration for all aspects of lawyer regulation in one office creates efficiency and economy of scale not present in many other states' lawyer regulatory programs.

### The Role of a Reserve

The Iowa client security rules do not specifically provide for a fund reserve, nor do fund reserves appear to be an express provision in the client security funds in other jurisdictions. However, the threshold set for the annual sufficiency calculation contemplated by Iowa Court Rule 39.6 in effect creates a minimum unencumbered fund balance of approximately \$600,000 at the beginning of each calendar year. At current operating expense levels, that minimum unencumbered fund balance allows the commission to operate for the calendar year and pay total claims of approximately \$300,000, at which point the actual fund balance at year end would decline to whatever revenue was collected during the year. Increasing the threshold for the annual sufficiency calculation would correspondingly increase the minimum unencumbered fund balance available to support operations and pay claims during the following calendar year. For example, doubling the rule 39.6 threshold to \$1,200,000 as proposed would make a minimum of \$900,000 available for claim payments, at current operating expense levels. Increasing the rule 39.6 threshold would have a short term effect on the frequency of special assessments, as noted in the discussion regarding effect on special assessments, below.

### Effect of Increased Assessments on Iowa Lawyers

The proposed rule change would leave the initial assessment payable by new lawyers at \$200.00. However, the rate at which that initial assessment would be paid would be changed to \$50 per year regardless of practice status. Lawyers admitted by examination within the past two years or in active duty military service status would remain exempt from payment of assessments into the fund. Lawyers categorized as government employees, full-time corporate employees, judges, or part-time practitioners currently contribute assessments of \$25.00 annually to the fund until they have paid their initial assessment to the fund. The installments payable by lawyers in these categories would increase to \$50 per year effective January 1, 2014. Lawyers classified as full-time practitioners would continue to contribute to the fund at the rate of \$50 each year until they have paid their initial assessment.

Once the initial assessment has been paid, no further assessment would be payable unless the sufficiency calculation required by Iowa Court Rule 39.6 results in an unrestricted fund balance of less than the amount specified in the rule as of December 1st. If that calculation declines below the specified threshold, a special assessment would be payable by all active lawyers during the next calendar year. The special assessment would be \$140 for all active lawyers who previously have paid their initial \$200 assessment. Lawyers categorized as government employees, full-time corporate employees, judges, or part-time practitioners currently pay a special assessment of \$25 in a special assessment year. Their special assessment would increase to \$140. Lawyers classified as full-time practitioners currently pay a special assessment of \$100 in a special assessment year. Their special assessment would increase to \$140 also.

<b>Assessments Payable by Attorneys in Various Client Security Statuses Under Proposed Changes</b>						
	Initial Assessment				After Initial Assessment Has Been Paid	
Client Security Status	Year of Admission	Year After Admission	Following Years, Until Initial Assessment is Paid		Not a Special Assessment Year	Special Assessment Year
Full Time	\$0	\$0	\$50		\$0	\$140
Part Time	\$0	\$0	\$50		\$0	\$140
Judge	\$0	\$0	\$50		\$0	\$140
Corporate	\$0	\$0	\$50		\$0	\$140
Government	\$0	\$0	\$50		\$0	\$140
Military	\$0	\$0	\$0		\$0	\$0

### Effect on Future Special Assessments

The following table projects the likely future special assessment years in two scenarios. The first scenario assumes the proposed rule changes are adopted. The second scenario assumes the proposed rule changes are not adopted. In each scenario, compensable claims currently pending before the commission are assumed paid, subject to existing reimbursement limits. The projections assume commission operating expenses at the 2013-2014 budget level, increasing at 2 percent per year. Future claim and trustee fee payments are assumed to total \$80,000 each year, and the value of pending claims is assumed to total \$250,000 as of each December 1<sup>st</sup>. In both scenarios, the fund reduction resulting from payment of compensable claims currently

pending before the commission likely will combine with other factors to cause serial special assessments in the next few years.

Scenario 1, based on the proposed rule changes, assumes that the initial assessment of \$200 remains the same, but is payable at the rate of \$50 per year. The special assessment is assumed to be \$140 for all active lawyers in those years when a special assessment is payable. Claim reimbursement limits are doubled, effective for claims arising from conduct after January 1, 2014. The rule 39.6 threshold for sufficiency calculations is increased from \$600,000 to \$1,200,000. Based on these assumptions, a special assessment at the new standard amount of \$140 for all active lawyers would be payable during 2014 and 2015, and thereafter every three to four years.

Scenario 2 is based on the current rules with no changes. Based on this assumption, a special assessment at the current levels would be payable two or three times during every four year period. It is likely that two consecutive years of special assessments would be payable in 2014 and 2015, and possible that special assessments could for three consecutive years, in 2014, 2015, and 2016.

		Likely Special Assessment Years													
Line	Scenario	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	
1	\$100K / \$300K Reimbursement Limits; Initial Assessment \$200 Payable \$50/Year; Special Assessment Standardized at \$140; \$1,200,000 Sufficiency Threshold	X	X			X				X			X		
2	No Changes: \$50K/\$150K Reimbursement Limits; Initial Assessment \$200 Payable at Rates Based on Status; Special Assessments \$25 or \$100 Based on by Status; \$600,000 Sufficiency Threshold	X	X	X		X		X	X		X	X		X	

### How Iowa's Fund Compares with Other States

A copy of the American Bar Association's compilation of information on client security fund claim limits across the various jurisdictions is available at the web address set out below, as part of a full ABA report regarding client security trust funds. Iowa's current per-claimant limit appears to be in the middle of the range. Iowa's aggregate per-attorney limit appears to be in the lower part of the range.

Doubling the reimbursement limits as proposed would move Iowa's per-claimant limit to the upper middle part of the range, and would move Iowa's per-attorney limit to the middle part of the range.

[http://www.americanbar.org/content/dam/aba/administrative/professional\\_responsibility/2011\\_cpfn\\_survey.authcheckdam.pdf](http://www.americanbar.org/content/dam/aba/administrative/professional_responsibility/2011_cpfn_survey.authcheckdam.pdf)

Iowa's normal mandatory annual fee of \$185 consists of \$10 to support the continuing legal education program and \$175 to support the lawyer discipline system. At \$185, the annual fee in Iowa ranks 46th of 51 states and the District of Columbia, or the fifth lowest annual fee in the United States.<sup>1</sup> When the maximum possible *current* special assessment of \$100 is added, the annual fee of \$285 in Iowa ranks 31<sup>st</sup> of 51 jurisdictions. When the maximum *proposed* special assessment of \$140 is added, the annual fee of \$325 in Iowa ranks 25<sup>th</sup> of 51 jurisdictions. The average annual fee in the United States is \$336.

---

<sup>1</sup> Based on the International Survey of Attorney Licensing Fees, compiled July 1, 2012 by the New Jersey Office of Attorney Ethics.